



**U.S. Department of Housing and Urban Development
Office of Public and Indian Housing**

Special Attention of:
Public Housing Directors;
Public Housing Agencies;

NOTICE: PIH-2007- 15 (HA)

Issued: June 20, 2007

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Subject: Applicability of Public Housing Development Requirements to Transactions between Public Housing Agencies and their Related Affiliates and Instrumentalities

I. Introduction

- A. **Purpose.** The U.S. Department of Housing and Urban Development (Department) has encouraged the formation of new and innovative public and private partnerships to ensure long-term sustainability of public housing developments and the leveraging of public and private resources to transform communities. Public Housing Agencies (PHAs) continue to form and expand their relationships with private partners, including partnerships with entities related to the PHA.

The Office of Inspector General (OIG) in report No. 2004-AT-0001 has alleged violations of the Annual Contributions Contract (ACC) and regulations in agreements regarding development activities and PHA relationships with affiliated housing development entities and non-profit organizations. This notice intends to reaffirm the requirements of Public and Indian Housing Programs including the United States Housing Act of 1937 (Act), the ACC, and regulations (collectively, public housing requirements) that apply to public housing activities, including mixed-finance development activities. This notice will also assist PHAs in avoiding violations of existing requirements in development transactions with their partners. The Department intends to use this notice to focus on existing development related requirements applicable to administrative fees and development cost allocation; prohibition of conflicts of interest; the procurement of related entities; and disposition and encumbrance of public housing property. Moreover, this Notice will focus on these requirements as they pertain to Affiliates and Instrumentalities, entities through which PHAs are conducting development activities.

Additionally, this notice will provide guidance to the Department's Headquarters and field office staff on identifying transactions that have not been approved by the Department and addressing the issues that arise in the transactions.

- B. **Applicability.** This notice applies to public housing development activities pursuant to 24 CFR Part 941. This notice does not apply to development or management of non-public housing programs that are not funded with public housing funds, even if carried out by entities related to the PHA. This notice also does not apply to PHA instrumentalities, affiliates, consortia or joint ventures providing administrative management, supportive or social services pursuant to Section 13 of the Act and its implementing regulations at 24 CFR Part 943. Notwithstanding any provision of this notice, Moving to Work (MTW) participants may continue to operate in accordance with their MTW Agreements with the Department.
- C. **The Department's policy.** The Department encourages PHAs to take innovative approaches to implementation of public housing programs including the creation of partnerships to increase the capacity and experience of the PHA. PHAs have diverse experience and skills and must evaluate what is in the interest of the PHA and its clients prior to utilizing an Affiliate or Instrumentality for development and/or the operation of public housing programs.¹ If the PHA determines that the use of an Affiliate or Instrumentality to assist in the development of public housing and to administer and manage PHA programs is in the best interest of the PHA, the Department encourages PHAs to use Affiliates and Instrumentalities, so long as the implementation of the public housing program is consistent with the applicable public housing requirements.
- D. **Program requirements.** Similar to PHAs themselves, Affiliates and Instrumentalities are created under state laws, so their basic powers and functions are governed by state and local law and further defined in their organizational documents, rather than being defined by federal statutes and regulations. The Department's regulatory authority over PHAs and their Affiliates and Instrumentalities derives from the requirements of the Department's programs that are administered by the PHA, Affiliate or Instrumentality. Thus, when an Affiliate or Instrumentality participates in a public housing development program it becomes subject to existing requirements.
- E. **Terms.** While the Department's regulations permit the PHA to develop public housing through a variety of ownership structures, the following are types of entities that are used in the practice of public housing development:

¹ This notice only covers development activities and activities related thereto.

1. An “**Affiliate/Affiliated entity**” is an entity, other than an Instrumentality, formed by the PHA under state law in which a PHA has a financial or ownership interest or participates in their governance. The PHA as an institution has some measure of control over the assets, operations, or management of the Affiliate, but such control does not rise to the level of control to qualify the entity as an Instrumentality. In addition, for the purpose of this notice, the definition of Affiliates includes only those entities that use public housing funds to carry out public housing development functions of the PHA. Except as specified in this notice, an Affiliate is treated like an unrelated third party contractor.

2. An “**Instrumentality**” is an entity related to the PHA whose assets, operations, and management are legally and effectively controlled by the PHA, through which PHA functions or policies are implemented and that utilize public housing funds or public housing assets for the purpose of carrying out public housing development functions of the PHA. For the Department’s purposes, an Instrumentality assumes the role of the PHA and is the PHA under the public housing requirements for purposes of implementing public housing development activities and programs. See 24 CFR 5.10, definition of a PHA. Instrumentalities must be authorized to act for and to assume such responsibilities. In addition, an instrumentality must abide by the public housing requirements that would be applicable to the PHA.

F. **Definitions.** For the purpose of this notice the following terms and phrases apply:

1. “**Public housing assets**” means public housing property, including real and personal property, tangible and intangible; and, tenant rents, used in connection with public housing that has been developed, acquired, or assisted with public housing funds.

2. “**Public housing units**” is the same term used in 24 CFR Part 941 and includes homeownership units developed with public housing funds prior to the transfer of title to the homebuyer.

3. “**Public housing funds**” means funds appropriated to implement programs authorized under the Act, including funds appropriated under Section 9 and 24 of the Act, excluding funds appropriated under Section 8 of the Act.

4. **“Public housing requirements”** means all requirements applicable to public housing, including without limitation, requirements pertaining to public housing under the Act, the Department’s implementing regulations and the ACC.

II. Formation of Instrumentalities and Affiliates

This section provides guidance on the fiduciary and organizational linkages between Affiliates, Instrumentalities and PHAs. It describes the extent to which public housing funds can be used to form Affiliates and Instrumentalities. The second part of this section specifically focuses on the relationship between PHAs and Instrumentalities that were formed with public housing funds.

Under the existing public housing structure there is usually one PHA in a jurisdiction. Therefore, any entity that does business with the PHA is presumed to be a contractor. An entity will be treated as a contractor unless it is made clear by the PHA that it should be treated differently, e.g., as an Instrumentality. The PHA may obtain a private legal opinion, an opinion from the local government, or guidance from the Department that the entity is an Instrumentality under HUD regulations and has the requisite powers and delegated authority to carry out the responsibilities of the PHA for development purposes under the applicable public housing requirements. If no such opinion is obtained, the PHA should look to the indicia of control over the entity as the basis for the PHA treating the entity as an Instrumentality (see Section B.1 below). Otherwise, the entity will be treated as a contractor.

- A. **Use of Federal funds to form Affiliates and Instrumentalities.** Public housing funds may be used for administrative expenses incurred in the formation of an Affiliate or Instrumentality created to develop and operate a PHA’s public housing development programs.
 1. Public housing funds may be used for costs related to forming an Affiliate or Instrumentality. If an Affiliate or Instrumentality is formed with public housing funds solely for developing a mixed-income and/or mixed-use development, the development must contain public housing units, although it may contain Low Income Housing Tax Credit (LIHTC) units, other affordable units, market rate housing, and commercial development. (See section 9 of the Act). Subject to the requirements discussed in Section III, the PHA may also use public housing funds for the costs of preparing and submitting a tax credit application, where it is developing public housing units in a mixed-income project, a mixed-use project, or a project that consists solely of public housing units, some of which are also LIHTC units.

2. Public housing funds **may not** be used to pay the cost of forming an Affiliate/Instrumentality created for the sole purpose of developing LIHTC or market rate developments that do not include any public housing units. In this event, the organizational costs must be paid with non-public housing funds, which includes de-federalized fees paid to the Central Office Cost Center.
3. Where multiple projects are contemplated, the first project must contain some public housing units. Public housing funds can be used, subject to the requirements discussed in Section III, to establish an Affiliate or Instrumentality that intends to develop multiple projects, some of which may not include public housing units as long as the first project includes public housing units. However, public housing funds appropriated under the Act must not be used to finance or develop the projects or phases that do not include any public housing units.

B. **Indicia of control necessary to determine an Instrumentality.**

Instrumentalities will be considered, for purposes of the public housing program, to be the PHA. As such, the Instrumentality must have the authority to carry out proposed activities of the PHA. Generally, the requirements are assumed to be met where the Instrumentality is created as a division within the existing structure of the PHA. The following factors should be considered in the formation and operation of an Instrumentality of the PHA which is a separate legal entity from the PHA.

- a. The Instrumentality is directed or managed by the same persons who constitute the board of directors or governing body of the PHA or who are employees of the PHA.
- b. Board positions on the Instrumentality may be associated with an employment position at the PHA or appointed by such persons. In the event of a PHA staff change, the PHA would appoint another employee to the board of the Instrumentality.
- c. The organizational documents of the Instrumentality contain provisions that in the event of a change in the controlling interest of the Instrumentality, all public housing assets of the Instrumentality are returned to the PHA or are otherwise protected.
- d. The organization is a component unit of a primary government using the suggested criteria and tests included

in the Government Accounting Standards Board Statement 14.

2. An Instrumentality must abide by the public housing requirements that would be applicable to the PHA.

III. Allocation and Source of Funds for the Cost of Shared Resources

This section includes allocation of formation costs discussed in Section II of this notice, and provides guidance on fiscal management and cost allocation when public housing funds are involved in a development activity. As a general rule, public housing funds may only be used for the development, administration, or management of a project that contains public housing units subject to the authority by which the funds were appropriated. The costs to carry out the administrative, management, or development functions for a project containing no public housing units shall be paid for with funds other than public housing funds. The PHA has the option of using the cost allocation system as outlined in this section or a fee based approach in lieu of cost allocation as outlined in Section B.

- A. **Basic cost allocation requirements.** Where staff, facilities, equipment, or other resources are shared between a PHA and an Affiliate/Instrumentality, or between the public housing program and non-public housing programs, the costs must be equitably allocated to each entity or program. This is the cost allocation principle that is the norm for both public and private business practices, and it applies to the development of public housing. The same cost allocation requirements apply where a PHA's employee performs work for an Affiliate as a consultant or other type of contractor. In the case of mixed-finance development the number of public housing units must be approximately proportionate to the PHA's contribution compared to the number of non-public housing units and the contribution from other sources. (See section 35 of the Act). OMB Circular A-87, Cost Principles for State and Local Governments (A-87), (2 CFR part 225) contains several provisions on this subject, including the following:
 - Attachment A, Sec. C.3.a. "A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received."
 - Attachment A, Sec. D.1. "The total cost of Federal awards is comprised of the allowable direct cost of the program, plus its allocable portion of allowable indirect costs, less applicable credits."
 - Attachment B, Sec. 8.h.(4). "Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation... unless a statistical sampling system... or other

substitute system has been approved by the cognizant Federal agency.”

B. Fee based structure. PHAs may use a fee based structure in lieu of cost allocation systems. Where the PHA earns certain fees, as detailed in the Financial Management Handbook, it may use the fees as the PHA wishes, including to pay Affiliate or Instrumentality costs. This structure is permitted under Section A(2)(b) of Attachment A of A-87 as an alternative to reduce the administrative burden regarding the establishment of overhead rates.

1. *Reasonable fee amount.* This section is applicable to mixed-finance development activities approved under 24 CFR 941 Subpart F that include the use of Capital Funds, HOPE VI funds, or other public housing capital assistance eligible to be used for development. When using public housing funds, a reasonable administrative fee is 3% of the total project budget. The administrative fee may be paid with public housing funds and covers the PHA’s administrative cost for the mixed-finance development activities. (See the Department’s Cost Control and Safe Harbor Standards for Rental Mixed-Finance Development, Revised April 9, 2003.) The total project budget includes all hard and soft development costs paid with both public and private financing. The total project budget should exclude Community and Supportive Services (CSS) costs for the purpose of calculating the administrative fee. If the administrative fee is at or below the 3% safe harbor standard, no further review is required. Alternatively, the PHA may charge up to a 6% administrative fee provided the PHA demonstrates to the Department, in writing, that the fee is appropriate for the scope of work, specific circumstances of the project, and local or national market for the services provided.
2. *Treatment of fees.* Under OMB Circular A-87, a PHA that receives federal and non-federal funds must assure that it is not disproportionately allocating overhead to federal programs. In the case where the PHA is charging within the approved amount for administrative fees for mixed-finance development, this concern is assumed to be satisfied.
 - a. For PHAs undertaking development, any administrative fee that the PHA charges for mixed-finance development programs is considered non-program income for purposes of A-87 and 24 CFR Part 85, provided that the fees charged are reasonable under the criteria established by the Department; however, other state and local restrictions may

still apply. Consequently, any reasonable fees earned by the PHA will be treated as local revenue subject only to the controls and limitations imposed by the PHA's management, board or other authorized governing body. The PHA is not required to document or demonstrate actual costs to earn the administrative fee. Additionally, the PHA is not required to distinguish or separately account for the expenses or costs associated with the administrative fee earned from its public housing development programs.

- b. A PHA may use the administrative fee for any purpose appropriate for local revenue, including PHA, Instrumentality, or Affiliate costs, such as to pay the Central Office Cost Center or to hire external consultants including a program manager, development advisors, or relocation specialists. The administrative fees or costs incurred must be within the administrative fee limits.
- c. PHA fees and or assets derived from non-public housing funds and non-public housing assets are not subject to the provisions of this notice.

- C. **Accounting and reporting requirements.** PHAs and Instrumentalities must comply with Generally Accepted Accounting Principles (GAAP) reporting requirements (24 CFR 5.801). This includes the Instrumentality providing the PHA and the Department with audited financial statements and financial performance reviews. If an Affiliate is included as a component unit or, to the extent that these accounting and reporting requirements apply to unrelated third party contractors, then Affiliates must also comply. (See PHA GAAP Flyer, Vol. 1, Issue 3, July 1999).

IV. Conflicts of Interest

PHAs are bound by conflict of interest provisions found in both the ACC and in HUD regulations at 24 CFR Part 85. Instrumentalities and Affiliates are also bound by these requirements. Conflict-of-interest questions can arise in transactions by PHAs, their Affiliates and Instrumentalities. This section highlights contractual and regulatory provisions that address conflicts of interest.

We discuss below the overarching standards for Part 85 and the ACC, respectively. As a practical matter, the Department is most concerned with conflicts of interest resulting in an actual or perceived personal financial benefit to agents of the PHA, Instrumentality and Affiliate involving public housing funds. Such instances create, at a minimum, a perception of abuse of authority and self-dealing in a federal program. In such instances the Department will closely scrutinize the transactions and will consider all available remedies for resolving these conflicts.

The following provides an overview of conflict-of-interest concepts generally and provides excerpts from the ACC and other Department regulations.

A. **Conflict of Interest.** PHAs and Instrumentalities are to avoid situations in which agents of those entities participate in contracting related decision making that results in a benefit received by that agent or person linked to that agent. In addition, the PHA's Instrumentalities and Affiliates may not contract with a third party in which certain PHA officials, their immediate family and certain local officials have an interest. Participation by a representative of the PHA (e.g., board member, employee, officer) in the PHA's Instrumentality is not, per se, a conflict; nor is a representative's participation in an Affiliate, so long as the representative and certain persons related to that representative do not have an interest in the Affiliate. Under the Departments regulations, the PHA, and therefore its Instrumentality, must develop standards for determining whether someone has a conflict of interest in a matter involving the PHA and any other party.

1. *Prohibited individuals.* The conflict-of-interest provision applies to an individual that is a member of the prohibited class as listed in Section 19 of the ACC or 24 CFR section 85.36(b)(3) (e.g., a PHA employee, officer or agent, any member of his or her immediate family, his or her business partner, or an organization which employs or is about to employ any of the above). Personal financial interests of an individual not specifically enumerated as covered, or individuals specifically exempted (e.g., tenant commissioners, under the ACC) do not constitute a conflict of interest under either the ACC or Part 85.
2. *Decision making capacity.* Under Part 85, a conflict of interest exists if an agent of the PHA/Instrumentality will participate in the award or administration of the contract supported by federal funds, and the decision, influence, award, or administration results in a benefit, actual or perceived, to the prohibited individual. However, the ACC strictly prohibits, without a waiver, contracting with an entity in which a prohibited individual has any financial interest regardless of the individual's decision making capacity.
3. *Applicability to Employment Sharing Arrangements* There is no conflict of interest where an agent of the PHA, Affiliate, or Instrumentality receives a normal and customary compensation package for employment by the PHA or the Affiliate/Instrumentality, including compensation provided to the employee by the PHA or the Affiliate/Instrumentality. For

example, a bonus provided by the PHA to the development director or payrolled employee for their service to the Instrumentality/Affiliate would not be considered a financial interest, if consistent with the PHA's customary compensation package. Where the PHA permits its staff to provide services to an Affiliate or Instrumentality the allocation of the salary expenses between these entities do not create a conflict of interest for the individual employee.

B. Consolidated Annual Contributions Contract (ACC) – Section 19. Affiliates/Instrumentalities are not exempt from the conflict-of-interest prohibition that applies to public housing in general. As discussed in Section I.E, an Instrumentality is construed as the PHA and an Affiliate is considered a contractor. The prohibition of conflicts of interest is stated in Section 19 Part A of the ACC, Form HUD-53012A (7/95).² “(1) In addition to any other applicable conflict-of-interest requirements, neither the PHA nor any of its contractors or their subcontractors may enter into any contract, subcontract, or arrangement in connection with a project under this ACC in which any of the following classes of people has an interest, direct or indirect, during his or her tenure or for one year thereafter.”

1. “(A)(1)(i) Any present or former member or officer of the governing body of the HA [housing authority] or any member of the officer's immediate family. There shall be excepted from this prohibition any present or former tenant commissioner who does not serve on the governing body of a resident corporation, and who otherwise does not occupy a policymaking position with the resident corporation, the HA or a business entity.”
2. “(A)(1)(ii) Any employee of the HA who formulates policy or who influences decisions with respect to the project(s), or any member of the employee's immediate family, or the employee's partner.”
3. “(A)(1)(iii) Any public official, member of the local governing body, or State or local legislator, or any member of such individuals' immediate family, who exercises functions or responsibilities with respect to the project(s) or the HA.”

² PHAs should examine their ACCs as some PHAs may still be operating under older versions of the ACC and those terms will apply.

C. **The Department's Regulations: 24 CFR Part 85**

The Department's regulations that apply to procurement by a PHA or its subgrantees, 24 CFR Part 85, contain a similar prohibition against real or apparent conflict of interest. The prohibition of conflicts of interest is stated in 24 CFR 85.36(b)(3).

“Grantees and subgrantees will maintain a written code of standards of conduct governing the performance of their employees engaged in the award and administration of contracts. No employee, officer or agent of the grantee or subgrantee shall participate in selection, or in the award or administration of a contract supported by Federal funds if a conflict of interest, real or apparent, would be involved. Such a conflict would arise when:

- (i) The employee, officer or agent,
- (ii) Any member of his immediate family,
- (iii) His or her partner, or
- (iv) An organization which employs, or is about to employ, any of the above, has a financial or other interest in the firm selected for award. The grantee's or subgrantee's officers, employees or agents will neither solicit nor accept gratuities, favors or anything of monetary value from contractors, potential contractors, or parties to subagreements. Grantee and subgrantees may set minimum rules where the financial interest is not substantial or the gift is an unsolicited item of nominal intrinsic value. To the extent permitted by State or local law or regulations, such standards or conduct will provide for penalties, sanctions, or other disciplinary actions for violations of such standards by the grantee's and subgrantee's officers, employees, or agents, or by contractors or their agents. The awarding agency may in regulation provide additional prohibitions relative to real, apparent, or potential conflicts of interest.”

D. **Waiver.** If the Department determines there is good cause, the PHA may obtain from the Department a written waiver of Section 19 of the ACC and an exception to the conflict-of-interest provisions in 24 CFR Part 85.36(b)(3).

E. **Applicability to Instrumentalities.** An Instrumentality is construed as the PHA in conjunction with public housing development activities. As such, there is no inherent conflict of interest regarding transactions between a PHA and its Instrumentality within the sphere of activity. An Instrumentality is required to follow the ACC and Part 85 conflict-of-interest provisions in its contracting with third parties, as though it were the PHA.

V. PHA Selection of Affiliates/Instrumentalities/Owners Entities and Procurement by Those Entities.

In all cases, when a PHA or its Instrumentality expends public housing funds as part of a development activity, procurement of development partners is governed by 24 CFR Part 85 and 24 CFR 602(d)(1). This section provides an overview of how the procurement requirements apply to Affiliates/Instrumentalities and mixed-finance owner entities engaged in development activities with the PHA.

A. Instrumentality

1. *Selecting the Instrumentality.* A PHA’s selection of an Instrumentality for development is not subject to 24 CFR Part 85. The Instrumentality is essentially the PHA under the public housing program and is controlled by the PHA. Therefore, the PHA need not procure an Instrumentality.
2. *Procurement by the Instrumentality.* An Instrumentality of the PHA that is created or selected to complete a public housing development activity is subject to 24 CFR Part 85 in selection of its partners and subcontractors. An Instrumentality must procure third party members of its operational or development team, i.e., architects, consultants, contractors, attorneys, etc. because the Instrumentality is subject to the same procurement requirements as the PHA (see 24 CFR Part 85 and 24 CFR Part 941).

B. Affiliate

1. *Procurement of the Affiliate.* PHA procurement of a PHA Affiliate is subject to the applicable provisions of 24 CFR Part 85 and 24 CFR Part 941. The PHA may choose to implement any of the methods of procurement outlined in 24 CFR 85.36, including procurement by noncompetitive proposals, as long as the preconditions to the use of that method are met. For purposes of mixed-finance development the affiliate may be procured in accordance with 24 CFR 85.36 as modified by 24 CFR 941.602(d).
2. *Selections by the Affiliate.* An Affiliate that has been procured by the PHA in accordance with Part 85 is not subject to Part 85 when the Affiliate contracts for goods or services, including services of the other members of its operational or development team, e.g., architects, consultants, contractors, and attorneys.

- C. Selection by an owner entity.** 24 CFR 941.602(d)(2) refers to the exercise of “significant functions” within the owner entity by the PHA or

an Instrumentality in order to determine whether the procurement of subcontractors is subject to 24 CFR Part 85.³ In a mixed-finance transaction, the procured developer typically forms the owner entity and assumes a role in the partnership. The following are examples of PHA or Affiliate/Instrumentality involvement in the owner entity.

1. If the PHA or its Instrumentality (by virtue of having been selected and not procured by the PHA) is a general partner or managing member of the owner entity or occupies a position that allows either the PHA or the Instrumentality to exercise significant functions as to the management of the development, then selections by the owner entity are subject to the provisions of 24 CFR Part 85.
2. If an Affiliate or any other entity (by virtue of having been procured by the PHA or Instrumentality) is the general partner or managing member of the owner entity (even if the Affiliate is occupying a position that allows it to exercise significant functions as to the management of the development), then the owner entity is not subject to the provisions of 24 CFR Part 85.
3. A PHA, Instrumentality, or Affiliate that has limited rights as a limited partner or minority member, including a purchase option or right of first refusal, does not qualify as exercising significant functions within the owner entity.

VI. Section 30, Capital Fund Financing and Public Housing Development

The following is a summary of the key program requirements affecting PHAs and their Affiliates/Instrumentalities participating in the development of public housing.

- A. **Section 30 of the 1937 Act: Public housing mortgages and security interests.** Private development firms, PHAs, Affiliates and Instrumentalities providing development functions for public housing development and/or mixed-finance housing development projects must conform to the requirements of section 30 (42 U.S.C. 1437z-2) to the extent they mortgage or grant a security interest in any public housing asset. In general, entities may not mortgage or otherwise grant a security interest in any public housing project, asset, or other property of the PHA without the prior written approval of the Assistant Secretary for Public and Indian Housing or the Deputy Assistant Secretary for the Office of Public Housing Investments (OPHI). With the exception of security interests in

³ The Procurement Process chapter of the Mixed-Finance Guidebook provides additional detail on this topic.

public housing appurtenances such as administration buildings, the Declaration of Trust (pursuant to section 8 of the ACC and section 9 of the Act) must be recorded before any mortgage or security interest on a public housing project.

- B. Capital Fund Financing Program.** PHAs may participate in the financing element of the Capital Fund under the Capital Fund Financing Program (CFFP). A PHA may borrow private capital to make improvements and pledge, subject to the availability of appropriations, a portion of its future year annual Capital Funds to make debt service payments for either a bond or conventional bank loan transaction. The loans or bonds are obligations of the PHA. The Department does not guarantee or insure these loans or bonds. No action taken under CFFP or section 30 shall result in any liability to HUD. The PHA obligation is subject to the availability of appropriations by Congress and compliance with statutory and regulatory requirements. A PHA must obtain written approval from the Department prior to executing any document that would encumber or pledge as collateral any public housing asset. This includes both physical assets and future public housing funding, such as Operating Funds or Capital Funds. In order to receive approval from the Department, a PHA must submit a financing proposal that includes a term sheet, financial documents, and a justification for the use of Capital Funds for financing.
- C. Public housing and mixed-finance development.** A PHA may use any generally accepted method of development outlined in 24 CFR Part 941. The purpose of the development program is to allow the PHA to develop public housing units that serve the needs of the public housing residents over the long term. The following is a summary of the public housing requirements applicable to the development of public housing units.
1. *Mixed-finance development.* Private development firms and/or Affiliates and Instrumentalities undertaking mixed-finance development of public housing units must conform to applicable public housing requirements. Specifically, the entity must follow the requirements of 24 CFR Part 941, Subpart F – Public/Private Partnerships for Mixed-Finance Development of Public Housing Units, and the guidance and procedures established by the OPHI, including but not limited to the Mixed-Finance Guidebook (1998). The OPHI must approve the obligation of any public housing funds prior to the expenditure of these funds.
 2. *Other development methods.* Private development firms, Affiliates or Instrumentalities conducting development activities under 24 CFR Part 941, Subparts A, B, C, D, and E must conform to the requirements of the appropriate Subpart. The

PHA must ensure in its contractual arrangements that the partners will comply with all applicable public housing requirements. The Department's field offices will provide technical assistance, with respect to approvals, monitoring, and reviews. The Program Centers must approve the transaction before the obligation of any public housing funds.

3. *Environmental requirements.* Note that the references to 24 CFR Part 50 in 24 CFR 941.208 and 941.608(b)(6) are outdated. The federal environmental review will be performed by a local or state Responsible Entity pursuant to 24 CFR Part 58, unless the Department chooses to perform the review itself under Part 50. Participants in the development process, including public or private for-profit or non-profit entities and their contractors, may not commit any public or private funds to activities that would have an adverse environmental impact or limit the choice of reasonable alternatives unless one of the following conditions has been met: (1) The Department has received a certification and request for release of funds and has approved the request for release of funds; or (2) The Department has done an environmental review and approved the activity or project.

VII. Disposition and Encumbrance of Public Housing Property

Development transactions between PHAs and other parties, including Affiliates/Instrumentalities, frequently involve the disposition or the encumbrance of public housing property. The following provisions are reiterated to emphasize important restrictions and remind PHAs of their obligations associated with the receipt of public housing funds, which still apply where Instrumentalities and Affiliates are involved, and to specifically discuss the applicability of these provisions to Instrumentalities.

- A. **Consolidated Annual Contributions Contract, Part A (ACC) Form HUD-53012A (7/95).** The following are selected provisions of the ACC with particular application to transactions involving PHAs, Affiliates and Instrumentalities:
 1. Section 7 – Covenant Against Disposition and Encumbrances. This section states: “The HA shall not demolish or dispose of any project, or portion thereof, other than in accordance with the terms of this ACC and applicable HUD requirements. ... the HA shall not in any way encumber such project, or portion thereof, without the prior approval of HUD. In addition, the HA shall not pledge as collateral for a loan the assets of any project covered under this ACC.”

2. Section 8 – Declaration of Trust. This section states: “Promptly upon acquisition of the site of any project, the HA shall execute and deliver an instrument (which may be in the form of a declaration of trust, a trust indenture, or such other document as may be approved by HUD) confirming and further evidencing, among other things, the covenant of the HA not to convey or encumber the project except as expressly authorized in this ACC...”
 3. Section 9 – Depository Agreement and General Fund. This section states: “(B) All monies and investment securities received by or held for the account of the HA in connection with the development, operation and improvement of projects in accordance with an ACC with HUD shall constitute the “General Fund”...(C) The HA shall maintain records that identify the source and application of funds in such a manner as to allow HUD to determine that all funds are and have been expended in accordance with each specific program regulation and requirement. The HA may withdraw funds from the General Fund only for: (1) the payment of the costs of development and operation of the projects under the ACC with HUD; (2) the purchase of investment securities as approved by HUD; and (3) such other purposes as may be specifically approved by HUD. Program funds are not fungible; withdrawals shall not be made for a specific program in excess of the funds available on deposit for that program....These covenants apply to all public housing assets as defined in ..., including not only real estate, but also money, investment assets, future receipts from rents, operating subsidy and other sources, and any other type of tangible or intangible personal property that is a part of a public housing project” (ACC, Sec. 2, Definitions “Project”).
- B. PHAs, Affiliates, and Instrumentalities may not dispose of or encumber public housing property without the Department’s approval either under 24 CFR Part 970 or Part 941, or section 30 of the Act, as applicable.
- C. Examples. The following is a nonexclusive list of examples of general types of encumbrances that are prohibited by the ACC covenant without the prior written approval of HUD:
- a. A mortgage or other lien on project real estate;
 - b. Pledge or other encumbrance of public housing project funds, including tenant rents, and money on hand or future revenues;

- c. Use of project equipment, vehicles, or other tangible assets as collateral;
 - d. Creation of a claim against project assets, under a guaranty or indemnity agreement; and
 - e. Grant of a leasehold interest other than dwelling leases with eligible families in the project.
- D. **Exception: Disposition through mixed-finance development.** Transfer by deed or ground lease of public housing property to an Instrumentality, Affiliate or mixed-finance owner entity for the purpose of developing public housing through the mixed-finance method does not require written approval from the Department through 24 CFR Part 970. The PHA will provide a certification stating that the disposition is in compliance with the provisions of Section 18 of the Act. The Department will approve the transfer, sale or ground lease of public housing property as a component of the mixed-finance approval process.

VIII. Reimbursement of Public Housing Funds

This section outlines the reimbursement provisions for PHAs that improperly use public housing funds for expenses associated with the development of projects that do not contain public housing units. Additionally, the section outlines corrective actions that PHAs must take where a PHA creates mortgages or grants a security interest in public housing property without the prior written approval of the Department.

The Department may pursue enforcement actions in the event that the PHA is found to have violated the terms of the existing public housing requirements. At its option, the Department may pursue enforcement actions for violations of ACC, statutory, or regulatory requirements and/or allow PHAs to implement the cures described below.

- A. **Reimbursement for improper use of public housing funds for development.** PHAs that have used public housing funds, itself or through a private partner or an Affiliate/Instrumentality, to develop a project that contained no public housing units must reimburse or cause the reimbursement of such funds by the private partner or Affiliate/Instrumentality, as appropriate. Any development costs paid with public housing funds for the improvement of the non-public housing units or for the improvement of a site developed with no public housing units must be reimbursed to the PHA, unless otherwise directed by the Department.
- B. **Reimbursement improper use of public housing funds for development for development of mixed-finance communities.** PHAs that have used public housing funds, without prior written from the

Department, that resulted in the development of mixed-finance projects that include some public housing units must reimburse or cause the reimbursement of such funds to the PHA under the following circumstance:

In the case where a PHA did not previously obtain the Department's approval for the mixed-finance development, the PHA must reimburse all improper costs related to the improvement of the non-public housing units (both hard and soft costs) and/or for the improvement of the site. The Department may use a pro rata share test to ensure that public housing funds were not expended in a greater ratio than the amount of public housing units in the development. For example, if 25 percent of the units in the development are public housing units, the entity must reimburse any public housing funds spent over and above 25 percent of the development costs, excluding costs such as administration, demolition, relocation and supportive services.

- C. **Failure to obtain approval from the Department for section 30.** PHAs are to scrutinize any financial guarantees, loan agreements, indemnifications or security agreements entered into by the PHA, an Affiliate or Instrumentality to ensure that mortgages or other such documents that grant a security interest in any public housing project, public housing property or other public housing asset have been previously approved in writing by the Department. At the discretion of the Department, agreements entered without prior approval from the Department that potentially give third parties a claim on PHA assets in violation of public housing regulations must be terminated or restructured. The PHA must submit documentation to the Department, including all transactional documents, evidencing that such unapproved encumbrances or security interests have been terminated or restructured in a manner to satisfactorily remedy any violations of the public housing requirements.

IX. Monitoring and Reporting in the PHA Plan

Currently, the OPHI reviews and approves mixed-finance transactions that involve PHAs and their Affiliates/Instrumentalities and owner entities. The purpose of this section is to assist with the identification of those transactions that the Department has not approved.

Because the pertinent requirements are not peculiar to transactions involving Affiliates/Instrumentalities, the general approach described should create neither a heightened nor diminished level of scrutiny merely based upon the existence of an Affiliate or Instrumentality. The purpose of this notice is not to impose new or different requirements upon PHAs or the Department, but to assist in the interpretation of existing requirements in complex situations involving the use of Affiliates or Instrumentalities.

A. Audit Findings: A-133 Compliance Supplement

1. PHAs are required to disclose activities with Affiliates/Instrumentalities in audited financial statements. The information provided should include cost allocations and financial and accounting transactions between PHAs and their Instrumentalities and Affiliates. The annual audit should include a review of the PHA's use of public housing funds in agreements with Affiliates or Instrumentalities in accordance with OMB Circular A-133 Compliance Supplement.
2. The audit may also disclose the existence of encumbrances that have not been previously approved by the Department. To assist with this part of the review, paragraph 3 below provides a non-comprehensive list of types of transactions that the Department has approved for the use of public housing funds where encumbrances may arise. The identification of any of these types of transactions, without the Department's approval, may indicate non-compliance with existing ACC and public housing requirements as outlined in this notice.
3. The types of transactions include: project syndications, limited liability corporations/partnerships and/or partnership agreements, contractual relationships, and associated accounting between PHAs, Affiliates, Instrumentalities, and other entities involved with projects utilizing public housing funds and/or assets, bank loans, pledges or guarantees of repayment.
4. Any findings from the audit that are related to the encumbrance of public housing assets or formation and cost allocation activities of Affiliates/Instrumentalities will be resolved by the field office, in conjunction with the OPHI. Such findings could trigger a joint review by OPHI and the field office. A checklist that will be used to assist with that review is attached to this Notice as Appendix 1.

B. Development Activity Reporting: PHA Plan

1. In accordance with 24 CFR 903, the PHA is required to report disposition of public housing property and any public housing development activities to be entered into with Affiliates/Instrumentalities and other private development entities in the PHA Plan. The field office in the region where the PHA is located approves the PHA Plan. If the field office identifies any problematic disclosures in the PHA Plan, they will work with OPHI to review them as necessary.
2. The PHA Plan includes submission of the Annual Statement for HOPE VI, Mixed-Finance and Capital Fund Program in Part III. The PHA Plan also includes Implementation Schedules for each active grant that details the eligible activities, including development activities conducted with Affiliates

and Instrumentalities, to be funded and the budget of estimated sources and uses.

3. In accordance with the HOPE VI Notice of Funding Availability and 24 CFR 903, the PHA is required to report development activities in the PHA Plan. Additionally, the Department must separately approve all development transactions with Affiliates/Instrumentalities and private development entities that utilize public housing funds for the development. (See 24 CFR Part 941, Subparts A-F sections 941.302, 941.501, 941.612, & 941.614).
4. The approval referred to above is only for development transactions with Affiliates/Instrumentalities and private development entities that involve the use of public housing funds and assets. Non-public housing development activity is not subject to review and approval by the Department, and thus is not included in the PHA plan.

C. Procurement Review

Should a review be triggered, part of the process may include a review of procurement which should include an evaluation of compliance with the conflict-of-interest provisions that are included in the HUD Procurement Handbook, 24 CFR 85.36 and the ACC and reiterated in this notice.

D. Checklist

The Department's staff and PHAs may use the attached checklist (Appendix 1) as guidance for assessing compliance with the requirements discussed in this notice.

Signed:

/s/
Orlando J. Cabrera, Assistant Secretary for
Public and Indian Housing

Affiliate/Instrumentality Reference Sheet

Purpose:		
This reference sheet will assist in analyzing concepts covered in the PIH Notice regarding Affiliates and Instrumentalities.		
<u>Issue</u>	<u>Source Documents</u>	<u>Comments and Notice References</u>
<u>Determine Necessity of Review:</u>		
Does the PHA have any Instrumentalities (related entities that are effectively and legally controlled by the PHA), including but not limited to a Housing Development Corporation, nonprofit or for-profit entities?	<ul style="list-style-type: none"> •PHA Plan •Annual audit •Entity's organizational documents 	(See Notice Section I and II)
Does the PHA have any Affiliates (related entities that do not meet the definition of Instrumentality, but nevertheless the PHA has some measure of control over the entity in terms of organization, administration, or program activities)?	<ul style="list-style-type: none"> •Procurement records •Board resolutions •Entity's organizational documents 	(See Notice Section I and II)
(If the answers to both of the above threshold questions are “no”, it is unnecessary to proceed further).		
Have public housing funds been used and have public housing development activities been conducted via the Affiliate or Instrumentality?	<ul style="list-style-type: none"> •Development contract •PHA financial records •Invoices 	PHAs may work with Affiliates/Instrumentalities on non-public housing projects without public housing assistance without approval or review.
(If the answer is “no”, it is unnecessary to proceed further).		
Does the PHA have an approval from the Department for the public housing development activities conducted by the Affiliate/Instrumentality?	<ul style="list-style-type: none"> •Approval letter •Executed ACC Amendment •Annual PHA Plan 	The approval, ACC Amendment and PHA Plan should indicate that the PHA was working with the Affiliate/Instrumentality.
(If the answer is “yes”, it is unnecessary to proceed further).		

<u>Ascertain the Basic Facts:</u>		
If one or more of the types of entities identified above exist, ascertain the basic facts about its organization, administration and activities.	<ul style="list-style-type: none"> •Entity's organizational documents •Bylaws •Board resolutions •Articles of Incorporation 	The reviewer should become familiar with the organizational structure and relationship to the PHA.
<u>Programmatic Compliance Review:</u>		
<i>Formation</i>		
Did the PHA use public housing funds for the formation of an Affiliate or Instrumentality that has not performed public housing activities?	<ul style="list-style-type: none"> •PHA financial records •Entity invoices 	The reviewer may review to determine if public housing funds were used to pay for ineligible expenses. (Section II.A)
<i>Cost Allocation</i>		
If the PHA is utilizing cost allocation for shared staff, facilities, equipment, or other resources, do the allocations generally comply with OMB Circular A-87 (2 CFR Part 225)?	<ul style="list-style-type: none"> •Financial records •Accounting records •Invoices •Contracts 	The reviewer should determine if the PHA is allocating costs appropriately in accordance with Circular A-87. (Section III.A)
If the PHA is utilizing a fee based structure, are the fees for administration charged to the development below 3% of the total project costs or otherwise approved by the Department?	<ul style="list-style-type: none"> •Approval letter •Development proposal •Development budgets •Payroll records •Accounting records 	The budgets should indicate fees within the safe harbor or approval for charging a greater fee. (Section III.B)
To the extent required, are the entities complying with Generally Accepted Accounting Principles?	<ul style="list-style-type: none"> •Annual audits •Financial reviews 	The Audit should be free from findings. Affiliates need only comply with GAAP to the extent that they are required through contracts with the PHA, they are included as a component unit, or an unrelated third party would be required. (Section III.C)

<i>Conflict of Interest</i>		
The questions in this section should apply to all transactions involving public housing funds, regardless of the participation of an Affiliate or Instrumentality		
To what extent is there common membership on the governing boards of the PHA and Affiliate/Instrumentality?	<ul style="list-style-type: none"> •Organizational documents of the Affiliate/Instrumentality •Board records 	The reviewer should identify any parties that may be prohibited individuals in the transactions. (Section IV.A.1)
Is there a personal financial benefit to any of the prohibited individuals as determined in accordance with the guidance provided in Section IV of the Notice?	<ul style="list-style-type: none"> •PHA payroll records •Other payroll records for the prohibited individuals 	The reviewer should identify any parties with a personal financial benefit other than normal and customary compensation. (Section IV.A.2, B, C, and D)
If there is a personal financial benefit to a prohibited individual, has the Department issued a waiver of the ACC provisions and 85.36(b)(3) related to conflict of interest?	<ul style="list-style-type: none"> •PHA/HUD correspondence records • Organizational documents of the Affiliate/Instrumentality 	The reviewer should ensure that the waiver and exceptions requirements have been met. (IV.B and C)
Is there reason for a Departmental review or investigation of the PHA's procurement or contracting transactions with its Affiliate/Instrumentality?		
<i>Procurement</i>		
Is the PHA in compliance with the procurement regulation? Have all Affiliates or other development partners been appropriately procured?	<ul style="list-style-type: none"> •Procurement Handbook •Procurement records 	See Section V Generally
Does the PHA have an Instrumentality as defined in the Notice?	<ul style="list-style-type: none"> •PHA Plan •Annual audit •Entity's organizational documents 	Sections I.E.2, II.B
Has the Instrumentality followed Part 85 procurement practices in the selection of members of its Development Team?	<ul style="list-style-type: none"> •Contractual agreements •Procurement protocols for the Instrumentality. 	Section V

<i>Prohibition Against Encumbrances</i>		**The questions in this section should apply to all development transactions involving public housing funds, regardless of the participation of an Affiliate or Instrumentality**
Identify all developments that contain public housing, which are or have been developed, managed or operated by an entity other than the PHA, including Affiliates/Instrumentalities and private partners.	<ul style="list-style-type: none"> •PIC •PHA Plan •Declarations of Trust or Restrictive Covenants 	This information should be included in the PHA Plan (See Sections VI and IX.B)
With respect to those developments, has the PHA or the Affiliate/Instrumentality entered into agreements or commitments that encumber, pledge, or otherwise restrict public housing property or assets?	<ul style="list-style-type: none"> •Loan agreements •Guarantees •Documents recorded upon the deed relating to the property. 	Section VI. The reviewer should look for any unapproved transactions affecting Public Housing property.
With respect to those agreements, has the department previously reviewed and approved the transaction through a Mixed Finance approval, CFFP approval, Section 30 approval or otherwise?	<ul style="list-style-type: none"> •Mixed-finance approval •CFFP approval •Section 30 approval 	Section VI.B. These transactions are allowed with the Department's approval required under Part 941.
Is there sufficient indication of an unapproved prohibited encumbrance to justify an audit or separate review?		
<i>Disposition</i>		**The questions in this section should apply to all development transactions involving public housing funds, regardless of the participation of an Affiliate or Instrumentality**
Does the PHA have an approval under the Authority under 24 CFR 970 for the disposition of property?	•HUD disposition approval	Section VII.A.
Does the disposition fall under the Mixed Finance exception and have an approval of a mixed finance development under 24 CFR 941?	•HUD mixed-finance approval	Section VII.B.